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SUPREME COURT OF THE UNITED STATES.

LIBSON SHOPS, INC.,
Petitioner,

vs.

GUSTAVE F. KOEHLER, DISTRICT DIRECTOR OF INTERNAL REVENUE,
Respondent.

PETITION FOR WRIT OF CERTIORARI

To the United States Court of Appeals for the Eighth Circuit.

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IN THE

SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1955.

LIBSON SHOPS, INC.,
Petitioner,

vs.

GUSTAVE F. KOEHLER, DISTRICT DIRECTOR OF INTERNAL REVENUE,
Respondent.

PETITION FOR WRIT OF CERTIORARI

To the United States Court of Appeals for the Eighth Circuit.

To the Honorable the Chief Justice and the Associate Justices of the Supreme Court of the United States:

Your petitioner, Libson Shops, Inc., a Missouri corporation, respectfully prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Eighth Circuit in the cause styled "Libson Shops, Inc., Appellant, v. Gustave F. Koehler, Appellee," affirming the judgment of the United States District Court for the Eastern Judicial District of Missouri, Eastern Division.

The opinion of the Court of Appeals is reported at 229 F. (2d) 220, and a copy thereof is appended. A memorandum of the District Court containing findings of fact and conclusions of law is reported by Prentice-Hall at par. 72,721, 1955 Federal Tax cases and by Commerce Clearing House at 55-1 U. S. T. C., par. 9458, and a copy thereof is included in the record printed for the use of the Court of Appeals, nine copies of which are furnished pursuant to Rule 21.

JURISDICTION.

The judgment of the Court of Appeals was entered January 19, 1956. An order denying petition of appellant for rehearing was entered February 16, 1956. Jurisdiction of this Court to review the judgment of the Court of Appeals is conferred by the Act of June 25, 1948, c. 646, 62 Stat. 928, 28 U. S. C., § 1254.

QUESTION PRESENTED.

The question presented for review is whether the petitioner, as the surviving corporation in a statutory merger of the petitioner and 16 other corporations, in computing its federal income tax for petitioner's taxable period commencing on the date of the merger, is entitled to carry over and deduct from its gross income certain net operating losses sustained by three of the other merged corporations in taxable periods ended prior to the merger.

STATUTES INVOLVED.

The statutes involved are the Internal Revenue Code of 1939, Sections 23 (s) and 122, Section 211, Revenue Act of 1939, c. 247, 53 Stat. 862, as amended, particularly 122 (b) (2) (C), Section 330, Revenue Act of 1951, c. 521, 65 Stat. 452 [26 U. S. C., 1952 ed., Sections 23 (s), 122].

The pertinent text of the above statutes is appended.

STATEMENT OF THE CASE.

Petitioner is a Missouri corporation with offices in St. Louis, Missouri. The respondent is a former District Director of Internal Revenue for the District of St. Louis, Missouri. The case was commenced in the District Court as an action to recover the sum of approximately $13,000 in federal income tax and interest thereon alleged by petitioner to have been overpaid for its fiscal year ended July 31, 1950. The District Court's jurisdiction was based upon the Act of June 25, 1948, c. 646, 62 Stat. 932, 28 U. S. C., § 1340.

Petitioner was incorporated in Missouri on January 2, 1946, as Libson Shops Management Corporation, to supervise and manage the operations of certain other corporations incorporated at the same time or shortly thereafter, some in Missouri, and others in Illinois, for the sale at retail of ladies' apparel in shops located in those states. All of the outstanding stock of the petitioner and of each of the sixteen sales corporations was owned directly or indirectly by the same eight individuals and in the same proportions.

On August 1, 1949, petitioner and the other sixteen corporations merged under and in accordance with the laws of Missouri and the laws of Illinois. Pursuant to the terms of the merger, petitioner, with its corporate name changed to Libson Shops, Inc., was the surviving corporation; the petitioner revised its capital structure, and its stock was issued in exchange for the stock of the merged corporations, in the same proportions in which the stockholders had owned stock in the merged corporations.

Prior to the merger, two of the Illinois sales corporations and one of the Missouri sales corporations had sustained net operating losses from their respective businesses,

and each had an unused net operating loss carry-over at the time of the merger. After the merger, petitioner operated all of the stores which formerly had been operated by the respective merged corporations. Petitioner maintained separate accounting records for each of the stores. The stores formerly operated by the three corporations which had net operating loss carry-overs at the time of the merger sustained operating losses in the year following the merger.

In its income tax return for its first taxable year after the merger, petitioner claimed the aggregate amount of the net operating loss carry-overs from the said three corporations as a deduction. This deduction was disallowed by the Commissioner of Internal Revenue. Petitioner paid an asserted deficiency resulting in part from said deduction and filed a claim for refund, which was disallowed. Petitioner then instituted the present action in the District Court, which held petitioner was not entitled to the net operating loss deduction.

Petitioner appealed the decision of the District Court to the Court of Appeals. The sole question on the appeal was whether the petitioner, the surviving corporation in the statutory merger, is entitled after the merger to take a net operating loss deduction attributable to losses sustained by several of the merged corporations prior to the merger.

The material part of Section 122 (b) (2) (C) of the Internal Revenue Code of 1939, as amended, provides as follows:

> "(C) **Loss for Taxable Year Beginning After December 31, 1947, and Before January 1, 1950.**—If for any taxable year beginning after December 31, 1947, and before January 1, 1950, the taxpayer has a net operating loss, such net operating loss shall be a net

operating loss carry-over for each of the three succeeding taxable years, * * *"

The Court of Appeals affirmed the judgment of the District Court, holding petitioner was not entitled under the statute to the net operating loss deduction it claimed.

REASONS FOR ALLOWANCE OF THE WRIT.

The decision of the Court of Appeals in this case is in conflict with the decisions of two other Courts of Appeals on substantially the same question.

The conflicting decisions are as follows:

1. The decision of the Court of Appeals for the Second Circuit in **Stanton Brewery, Inc., v. Commissioner of Internal Revenue**, 176 F. (2d) 573 (1949), holding that the surviving corporation in a statutory merger under New York law was entitled under Section 710 (c) (3) (B) of the Internal Revenue Code of 1939 to carry over unused excess profits tax credits of the other merged corporation.

2. The decision of the Court of Appeals for the Ninth Circuit in **E. & J. Gallo Winery v. Commissioner of Internal Revenue**, 227 F. (2d) 699 (November 9, 1955), holding that the surviving corporation in a statutory merger under California law was entitled under Section 710 (c) (3) (B) of the Internal Revenue Code of 1939 to carry over an unused excess profits tax credit of the other merged corporation.

ARGUMENT.

1. The decision in the instant case is in direct conflict with the decision in the **Stanton Brewery** case.

In **Stanton Brewery**, it appeared that on December 31, 1941, the John Stanton Brewing and Malting Company had merged with its wholly-owned subsidiary, The Stanton Brewery, Inc. Both were New York corporations and the merger was effected under the New York Stock Corporation Law. The John Stanton Brewing and Malting Company, with its name changed to The Stanton Brewery, Inc., was the surviving corporation. In determining its adjusted excess profits net income for 1942, the surviving corporation deducted the unused excess profits credits of its merged subsidiary for 1940 and 1941. The Commissioner disallowed the deduction.

The tax statute involved was Section 710 (c) (3) (B) of the Internal Revenue Code of 1939, which in part provides:

> ". . . If . . . the taxpayer has an unused excess profits credit, such unused excess profits credit shall be an unused excess profits credit carry-over for each of the two succeeding taxable years . . ." 56 Stat. 901; 26 U. S. C., Sec. 710 (c) (3) (B).

The Second Circuit held that the surviving corporation in the merger was entitled to the carry-over.

The rationale of the decision in **Stanton Brewery** is as follows:

> (i) "Petitioner's claim is that, as 'the taxpayer' in the quotation [from Section 710 (c) (3) (B), supra] it is entitled to the carry-over from its component operating company's unused excess profits credit." l. c. 574.
>
> (ii) "'Taxpayer' is defined as 'any person subject to a tax imposed by this title' by I. R. C., Sec. 3797,

26 U. S. C. A., Sec. 3797, which also defines 'person' to include 'corporation.'" l. c. 576.

(iii) Petitioner, as the resulting corporation in a merger, "is liable for the taxes imposed upon its components." l. c. 576.

(iv) "Hence we conclude that . . . petitioner, who has absorbed the two former corporations, is 'the taxpayer' now obligated to pay their taxes and entitled to their credits." l. c. 576.

Comparing the **Stanton Brewery** case with the instant case, it is clear that the decisions are in conflict.

Section 122 (b) (2) (C), here involved, dealing with net operating loss carry-over, is otherwise identical in terms with Section 710 (c) (3) (B), dealing with unused excess profits credit carry-over, involved in **Stanton Brewery.**

The **Stanton Brewery** rationale, applied to the facts of the instant case, leads to the conclusion that petitioner is entitled to the carry-over:

(i) Petitioner is so entitled if it is "the taxpayer" within the meaning of Section 122 (b) (2) (C).

(ii) The statutory definition of "taxpayer" cited by the Court in **Stanton Brewery** applies here as well as there.

(iii) Petitioner here is subject to liability for taxes imposed upon the other merged Libson corporations, under the reasoning of the cases cited by the Second Circuit [176 F. (2d) 575] as applied to a surviving corporation in a merger pursuant to the Missouri and Illinois statutes.

(iv) Hence petitioner here is "the taxpayer" in Section 122 (b) (2) (C), entitled to the loss carry-over credits of the three merged corporations.

The Eighth Circuit Court of Appeals attempts to distinguish **Stanton Brewery** as involving the merger of one

operating corporation and a parent holding company, whereas the instant case involves the merger of 16 sales corporations and a management corporation. 229 F. (2d) 224.

The Court of Appeals regards this difference as material, because of the reference in **Stanton Brewery** to "a continuing enterprise." 176 F. (2d) 577.

The point is made that where there is only a single operating corporation both before and after the merger, there is a "continuing enterprise," but not so where there are several operating corporations before the merger. It is not necessary to consider whether this is a proper interpretation of the phrase used by the Second Circuit, because the reference to "continuing enterprise" does not enter into the essential rationale of the decision. The Court had already reached its conclusion, on the basis of the **language** of the statute before it, before making the reference to "continuing enterprise" in the course of discussing the **purpose** of the statute. 176 F. (2d) 577.

2. The decision of the Court of Appeals is also in direct conflict with the decision of the Ninth Circuit Court of Appeals in **E. & J. Gallo Winery v. Commissioner of Internal Revenue**, 227 F. (2d) 699 (November 9, 1955).

In that case it appeared that on December 19, 1945, Gallo Winery and Valley Agricultural Company, both California corporations, merged in accordance with Section 361 of the California Civil Code. Gallo Winery was the surviving corporation. At the time of the merger Valley Agricultural Company had an unused excess profits credit. The sole question on the appeal was whether Gallo Winery was entitled to use this credit as a carry-over in computing its excess profits tax net income for its taxable year ended April 30, 1946.

The tax statute involved was Section 710 (c) (3) (B) of the Internal Revenue Code of 1939, the same statute that was involved in the **Stanton Brewery** case, supra.

The Ninth Circuit held that Gallo Winery was entitled to the carry-over.

The rationale of the decision is as follows:

(i) In order to be entitled to the carry-over under Section 710, Gallo Winery must be "the taxpayer" within the meaning of the statute. l. c. 704.

(ii) Under applicable decisions of the United States Supreme Court, in all cases of corporate merger the identity of each merged corporation is deemed to persist in the surviving corporation for purposes of enabling the survivor to utilize tax credits of the other. This is true whether or not state law is held to control in determining the character and content of the continuing corporation in a merger, and whether or not there is a true statutory merger. l. c. 702-704.

(iii) The merger of Gallo Winery and Valley Agricultural Company was a statutory merger under California law, with the result that Valley in legal effect became an integral part of Gallo, citing Civil Code of California, Section 361 (5) and (7). l. c. 702. In any event there was a merger with the result, according to the Supreme Court decisions, that the corporate personality of Valley was "drowned" in that of Gallo. l. c. 705.

(iv) Thus Gallo was "the taxpayer" within Section 710 (c) (3) (B) of the Internal Revenue Code, and was entitled to the carry-over. l. c. 704-705.

Again, comparison of the **Gallo Winery** case with the instant case clearly points up the conflict in the decisions.

The language of the tax statutes is the same, as noted above.

The decisions of the Supreme Court referred to in **Gallo** are as applicable here as there. There was a merger here as in that case. Where the California merger statute (Sec. 361 [5]) says that the merging corporations "shall be one corporation," 227 F. (2d) 702, the corresponding Missouri and Illinois statutes say that they "shall be a single corporation." Mo. R. S., 1949, Section 351.450, and Smith-Hurd, Illinois Annotated Statutes, Section 157.69. Likewise the Missouri and Illinois statutes above cited provide that upon merger "the **separate** existence . . . shall cease" (emphasis supplied), which is the identical language used in the California statute. 227 F. (2d) 702.

The Court of Appeals in the present case made only a feeble effort to distinguish **Gallo Winery**. The Court first suggested that the case might be distinguishable as involving a "continuing enterprise" within the supposed meaning of that phrase as used in **Stanton Brewery**, but conceded that the facts disclosed in the opinion of the Ninth Circuit do not show this to be true (l. c. 226). In any event, this factor did not enter into the decision in **Gallo Winery**.

The Court then concluded:

> "Apparently the Gallo and Stanton cases stand on the same footing. Nevertheless, insofar as it can be said that they are parallel with the instant case, we must conclude that they are not persuasive." 229 F. (2d) 227.

Wherefore, your petitioner respectfully prays that a Writ of Certiorari be issued out of and under the seal of this Honorable Court, directed to the United States Court of Appeals for the Eighth Circuit, commanding that Court to certify and to send to this Court for its review and determination, on a day certain to be therein named, a full and complete transcript of the record and all proceed-

ings in the case numbered and entitled on its docket, No. 15,397, Libson Shops, Inc., Appellant, v. Gustave F. Koehler, District Director of Internal Revenue, Appellee; and that the said judgment of the United States Court of Appeals may be reversed by this Honorable Court, and that your petitioner may have such other and further relief in the premises as to this Honorable Court may seem meet and just; and your petitioner will ever pray.

Respectfully submitted,

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FREEMAN & HOLLAND.

APPENDIX.

1. Opinion of the Court of Appeals:

UNITED STATES COURT OF APPEALS
for the Eighth Circuit.

No. 15,397.

Libson Shops, Inc., Appellant,

vs.

Gustave F. Koehler, District Director of Internal Revenue, Appellee.

Appeal from the United States District Court for the Eastern District of Missouri.

[January 19, 1956.]

Owen T. Armstrong (Lowenhaupt, Mattingly, Chasnoff and Stolar were with him on the brief), for Appellant.

Harry Marselli, Attorney, Department of Justice (H. Brian Holland, Assistant Attorney General, and Ellis N. Slack and Harry Baum, Attorneys, Department of Justice, and Harry Richards, United States Attorney, were on the brief), for Appellee.

Before Gardner, Chief Judge, and Woodrough and Vogel, Circuit Judges.

Vogel, Circuit Judge.

The sole question involved in this case is whether the appellant, as the surviving corporation in a statutory merger of seventeen separate corporations, in computing

its net income for a taxable period commencing on the date of the merger, is entitled to carry over and deduct net operating losses sustained by three of the merged corporations in taxable periods ended prior to the date of the merger under the provisions of §§ 23(s) and 122 (b) (2) (C) of the Internal Revenue Code of 1939 (26 U. S. C. §§ 23(s), 122 (b) (2) (C) (1952)).

The facts, as found by the district court and as stipulated by the parties, may be summarized as follows:

The appellant, Libson Shops, Inc., is a Missouri corporation with offices in St. Louis, Missouri. It was originally incorporated on January 2, 1946, as Libson Shops Management Corporation to supervise and manage certain other corporations formed for the purpose of operating stores for the sale of women's wearing apparel. Its articles of incorporation also authorized it to engage in the business of selling apparel. Of the other corporations, ten were also incorporated in Missouri on January 2, 1946, one was incorporated in Missouri on January 8, 1946, and four were incorporated in Illinois on January 2, 1946. An additional corporation, Hampton Libson Shops, Inc., was incorporated in Missouri on May 28, 1948. All of the outstanding stock of each of the corporations was owned directly or indirectly by the same eight individuals and in the same proportions.

On August 1, 1949, pursuant to the laws of Missouri and Illinois, the seventeen separate operating corporations were merged into one, the taxpayer (appellant), and taxpayer's stock was issued in exchange for the stock of the merged corporations. Under the terms of the merger, the name of the taxpayer corporation was changed, the amount and par value of its stock was revised and its business purposes were extended. After the merger, the taxpayer, appellant, operated the stores which had formerly been operated by the merged corporations.

Prior to the merger, two of the Illinois corporations and one Missouri corporation had sustained net operating losses from their respective businesses.

In the year following the merger, that is the taxable year involved herein, each of the businesses formerly operated by such three corporations continued to sustain a net operating loss.

In its income tax return for the first taxable year after the merger, the taxpayer claimed as a net operating loss carry-over and deduction the net operating losses sustained before the merger by the three corporations above referred to. Such deduction was disallowed by the commissioner and the appellant paid the resulting tax deficiency. It then claimed a refund which was disallowed; whereupon, it instituted the present action. The district court held that the claimed net operating loss deduction was not permissible under the law and sustained the commissioner's disallowance of the deduction. This is an appeal from the district court's action.

The statute involved, insofar as it may be applicable herein, is as follows: Section 122 (b) (2) (C) Internal Revenue Code of 1939 as amended by Revenue Act of 1951, 65 Stat. 452, effective for taxable years beginning after December 31, 1948:

> "(C) Loss for taxable year beginning after December 31, 1947, and before January 1, 1950. **If for any taxable year beginning after December 31, 1947, and before January 1, 1950, the taxpayer has a net operating loss, such net operating loss shall be a net operating loss carry-over for each of the three succeeding taxable years,** except that the carry-over in the case of each such succeeding taxable year (other than the first succeeding taxable year) shall be the excess, if any, of the amount of such net operating loss over the sum of the net income for each of the intervening years computed." (Emphasis supplied.)

It is the appellant's position that the surviving corporation in a statutory merger, as distinguished from a new corporation in other kinds of reorganization, is entitled to carry over and deduct losses sustained in prior years by other parties to the reorganization.

Appellant concedes that in **New Colonial Ice Co., Inc. v. Helvering, Commissioner of Internal Revenue,** 1934, 292 U. S. 435, the Supreme Court ruled out the conclusion that the benefit of a carry-over extends to **any** successor. It argues that in the **New Colonial Ice** case, the statute involved was worded slightly differently than that with which we are here concerned, in that it provided that where "* * * any taxpayer has sustained a net loss * * *" the same shall be deducted from the net income of "the taxpayer" for the succeeding taxable year, whereas the statute here does not repeat the term "taxpayer". That is, the statute does not say if the taxpayer has a loss, such loss shall be a carry-over for succeeding taxable years **of the taxpayer.** It takes the position that the failure to expressly repeat the term "the taxpayer" is significant as suggesting that the statute does not limit the right to the carry-over to the person who sustained the loss. Appellant points out that "the right to the carry-over is stated in the passive voice—the statute does not say that, if the taxpayer has a loss **he** shall be entitled to a loss carry-over; that it says only that such loss **shall be** a carry-over". From this appellant argues that Congress was not concerned with who sustained the loss but with the fact of the loss itself, and that it intended to confer the tax benefit thereof to anyone who could associate himself with the loss, such as a successor corporation in a corporate reorganization.

Much is attempted to be made of little. We see no significance in the failure to repeat the term "taxpayer" in the present statute. In providing that if the taxpayer has a loss such loss shall be a carry-over, Congress could only

have meant such carry-over was for the benefit of the taxpayer referred to. Had Congress intended that this right to a loss carry-over be transferable to someone other than the original taxpayer, it would have said so. In **New Colonial Ice Co., Inc., v. Helvering, Commissioner of Internal Revenue,** supra, the Supreme Court said, at page 440:

> "* * * the statutes have disclosed a general purpose to confine allowable losses to the taxpayer sustaining them, **i. e.,** to treat them as personal to him and not transferable to or usable by another.
>
> Obviously, therefore, a taxpayer seeking a deduction must be able to point to an applicable statute and show that he comes within its terms."

The Supreme Court, in the case of **Interstate Transit Lines v. Commissioner of Internal Revenue,** 1943, 319 U. S. 590, 593, stated:

> "* * * the now familiar rule that an income tax deduction is a matter of legislative grace and that the burden of clearly showing the right to the claimed deduction is on the taxpayer. **New Colonial Ice Co. v. Helvering,** 292 U. S. 435, 440; **Deputy v. du Pont,** 308 U. S. 488, 493."

In order to obtain credit for the loss carry-over appellant must establish that it is the same "taxpayer" having the net operating loss.

Arriving at the same conclusion, the trial court stated the question herein as follows:

> "* * * is the survivor corporation the same as each of the corporations whose tax credit the merged corporation would appropriate?"

It found that there had been much more than a "comparatively minor change" (**Stanton Brewery, Inc., v. Commissioner of Internal Revenue** (C. A. 2, 1949), 176 F. 2d 573,

575) between the merged corporations and the appellant and concluded:

> "We cannot on this record hold plaintiff and any one of the corporations having either of tax credits in issue, is the same corporation.
>
> "There are far too many differences between the new or survival corporation and each of the old corporations that must fail to survive, to find the corporation surviving is for tax credit purposes the same as the corporations that have ceased to exist."

The trial court further stated:

> "The effect of a ruling such as plaintiff seeks would be establishing a precedent susceptible of wide-spread abuse. That is if Federal courts are to consider themselves bound by state laws and merger agreements under them in tax matters. Such a rule might result in a different Federal tax status for corporations in each state. * * * The law must operate uniformly. It cannot make fish of one and fowl another. And so bankrupt corporations with tax credits would find themselves the object of desirable purchase or 'merger' by or with corporations with tax liabilities, in order that after purchase the tax credits could be used to offset taxes due, just as plaintiff would do in this case. Regardless of what the motive or motives for including the corporations with tax credits in the merger, we have no doubt that use of their tax credits was one. The corporations holding the tax credits could not use them, as apparently the stipulation indicates the stores operated by the corporations having tax credits continued to lose money."

Appellant in this case relies principally upon **Stanton Brewery, Inc., v. Commissioner of Internal Revenue**, supra. The issue there, as stated by the majority opinion, was:

"* * * whether or not, after a merger, the resulting corporation is entitled, in determining its adjusted excess profits net income, to carry over the unused excess profits credit of one of its components for the two years preceding the merger."

The John Stanton Brewing and Malting Company had merged with its wholly owned subsidiary, The Stanton Brewery, Inc. Both were New York corporations and the merger was effected under the New York stock corporation law. The John Stanton Brewing and Malting Company, with its name changed to The Stanton Brewery, Inc., was the surviving corporation. In determining its adjusted excess profits net income for 1942, the surviving corporation deducted the unused excess profits credits of its merged subsidiary for 1940 and 1941. The commissioner disallowed the deduction. The statute therein involved was § 710 (c) (3) (B) of the Internal Revenue Code of 1939, which in part provides:

"* * * If * * * the taxpayer has an unused excess profits credit, such unused excess profits credit shall be an unused excess profits credit carry-over for each of the two succeeding taxable years * * *." 26 U. S. C., § 710 (c) (3) (B).

In considering the purpose of the statute, the court said, at page 574:

"As is well known, Congress sought by the excess profits tax, I. R. C. §§ 710-736, 26 U. S. C. A., §§ 710-736—imposed in 1940 and repealed in 1945—to capture for the government the amount of corporate profits of any one year which were excessive in relation to the like receipts during an earlier or base period (normally 1936-1939). But it was considered equitable that lean years should be set off against lush ones to strike some sort of average, and hence we have the device of the 'unused excess profits credit carry-back and carry-over' from one tax year to another."

The court held therein that since the successor corporation became directly liable under the laws of the State of New York for outstanding debts of the merged corporation, it should be deemed to be the same "taxpayer" as the merged corporation for purposes of applying the carry-over provision. It said that the successor corporation was a "* * * union of component corporations into an all-embracing whole which absorbs the rights and privileges, as well as the obligations, of its constituents," by operation of state law and accordingly was the "taxpayer" presently obligated to pay their taxes and entitled to their credits under the federal tax law.

The court stated, at page 577:

> "Our conclusion that petitioner is entitled to the unused excess profits credit carry-overs of its component corporations seems to us, therefore, the reasonable interpretation of the statutory language. Moreover it seems to us **the one which will carry out the evident statutory purpose, since it accords the privileges of the carry-over provisions to what is essentially a continuing enterprise,** entitled to all their benefits in ameliorating otherwise harsh tax consequences of fluctuating profits or expanding business." (Emphasis supplied.)

In a strongly dissenting opinion in the **Stanton** case, Judge Learned Hand stated, at page 578:

> "A statute so intricate and detailed as this leaves little latitude for interpretation. Moreover, I do not think that it is more consistent with any declared purpose that I can find, to extend the privilege of a 'carry-over' to the taxpayer at bar. Indeed, as the decisions cited in my brothers' opinion show, privileges, closely akin in purpose to this, are ordinarily lost by transfers by one corporation to another; and the form of the transfer cannot be important. We have no war-

rant for supposing that Congress in general regards such credits as parts of a 'universitas juris,' passing, with the chattels, choses in action and the rest, like good-will or trade marks."

Without taking issue with the majority's opinion in the **Stanton** case, we point out that it is distinguishable on its facts. The **Stanton** case involved the merger of one operating corporation and a parent holding company. The business carried on after the merger was substantially the same as that which had theretofore been carried on by the merged operating corporation, and without the merger the latter would have been entitled to the claimed carry-over. The majority opinion refers to the fact that the privilege of the carry-over is accorded to what they refer to as "essentially a continuing enterprise."

In the case before us, we do not have "essentially a continuing enterprise." We are concerned with the merger of seventeen corporations, each of them operating an individual enterprise. Sixteen of the corporations operated sixteen individual stores in sixteen different places, four of them in Illinois and the remainder in Missouri. The seventeenth corporation provided supervisory and managerial services for the other sixteen. The appellant here is attempting to pool seventeen separate enterprises and level the ups and downs of their economic fortunes. We can see no distinction (except corporation as opposed to individual) between the situation confronting us in this case and that in which seventeen individuals, each owning and operating a separate and distinct business, trying to pool their resources and liabilities into one ownership and thereby attempting to take credit for the loss carry-overs of three of the individuals whose enterprises had not returned a profit in the years prior to the combined ownership. The rule contended for by appellant would obviously give unfair advantage to corporations over individuals.

Uniformity of administration of tax laws should be assured all taxpayers.

It is argued that all of the outstanding stock of each of the corporations was owned directly or indirectly by the same individuals and in the same proportions, and that those stockholders have a like interest in the merged corporation, the appellant herein. In other words, we are asked to look behind the corporate fiction of the true owners, the stockholders.

In dealing with a somewhat similar contention, the Supreme Court in **New Colonial Ice Co., Inc., v. Helvering,** supra, stated, at page 441:

> "Thus the contention that the two corporations were practically the same entity and therefore the same taxpayer has no basis, unless, as the petitioner insists, the fact that the stockholders of the two corporations were substantially the same constitutes such a basis.
>
> "As a general rule a corporation and its stockholders are deemed separate entities (**Pullman Car Co. v. Missouri Pacific Ry. Co.**, 115 U. S. 587, 596-597; **Donnell v. Herring-Hall-Marvin Safe Co.**, 208 U. S. 267, 273; **United States v. Delaware, L. & W. R. Co.**, 238 U. S. 516, 527-529; **Cannon Mfg. Co. v. Cudahy Co.**, 267 U. S. 333; **Klein v. Board of Supervisors**, 282 U. S. 19, 24) and this is true in respect of tax problems. (**Klein v. Board of Supervisors**, 282 U. S. 19, 24; **Dalton v. Bowers**, 287 U. S. 404, 410; **Burnet v. Clark**, 287 U. S. 410, 415; **Burnet v. Commonwealth Improvement Co.**, 287 U. S. 415, 418-420.)"

Page 437:

> "The question presented is—where all the assets and business of an older corporation are taken over by a new corporation, specially organized for the purpose and having substantially the same capital structure,

in exchange for a portion of its stock, which is distributed by the older corporation among the latter's stockholders share for share, thereby retiring the old shares, is the new corporation entitled, notwithstanding the change in corporate identity and ownership, to have its taxable income for the succeeding period computed and determined by deducting from its net income for that period the net losses sustained by the older corporation in the preceding period?"

Page 439:

"The petitioner insists that **the continuity of the business was not broken** by the transfer from the old company to the new; and this may be conceded. But it should be observed that this continuity was accomplished by deliberate elimination of the old company and substitution of the new one. Besides, **the matter of importance here, as will be shown presently, is not continuity of business alone but of ownership and tax liability as well.** Had the transfer from one company to the other been effected by an unconditional sale for cash there would have been continuity of business, but not of ownership or tax liability." (Emphasis supplied.)

"Petitioner also insists that the ultimate parties in interest—stockholders and creditors—were substantially the same after the transfer as before; and this may be conceded. But there is here no effort to tax either creditors or stockholders."

Page 440:

"* * * but the statutes have disclosed a general purpose to confine allowable losses to the taxpayer sustaining them, i. e., to treat them as personal to him and not transferable to or usable by another."

"When § 204 (b) is read with the general policy of the statutes in mind, as it should be, we think it can-

not be regarded as giving any support to the deduction here claimed. It brings into the statutes an exceptional provision declaring that where for one year 'any taxpayer has sustained a net loss' the same shall be deducted from the net income of 'the taxpayer' for the succeeding taxable year; and, if such loss be in excess of the income for that year, the excess shall be deducted from the net income for the next succeeding taxable year. Its words are plain and free from ambiguity. Taken according to their natural import they mean that the taxpayer who sustained the loss is the one to whom the deduction shall be allowed. Had there been a purpose to depart from the general policy in that regard, and to make the right to the deduction transferable or available to others than the taxpayer who sustained the loss, it is but reasonable to believe that purpose would have been clearly expressed."

Appellant herein would avoid the import of the **New Colonial Ice** case by directing attention to the fact that that case did not involve a statutory merger of corporations and the instant case does. Appellant accordingly believes that the **Stanton** case is authority for its contention and that the **New Colonial Ice** case is not in point. As we have previously indicated, however, there is factual difference between the instant case and **Stanton.** That is true as to **New Colonial Ice** as well. It does not, however, detract from the force of the Supreme Court's statements in **New Colonial Ice,** supra, and that "* * * the matter of importance here * * * is not continuity of business alone but ownership and tax liability as well."

In tracing the identity of the "taxpayer", it would appear that the Supreme Court was concerned with both continuity of ownership and continuity of business. In the instant case we have seventeen separate businesses

now merged into one. We are of the opinion that this case lacks both of the essential elements necessary to establishing the appellant as the "taxpayer" entitled to the deduction. There is here neither continuity of ownership nor continuity of business.

While we do not consider it as a logical argument against the appellant's position and is, after a fashion, arguing backwards, it is nevertheless pointed out that to allow the credit here would produce a most unusual result. It would mean that **the merger** of these corporations **and the merger alone** would be responsible for the appellant obtaining the credit sought, for if the three corporations sustaining the loss had not merged they would not have been able to take credit for the loss carry-over as they continued to sustain losses. Thus the appellant here is seeking solely by virtue of the merger of the corporations to obtain a benefit which would not have been available to the individual corporations themselves. The income against which appellant seeks to offset the loss did not come from the same business enterprises which gave rise to the loss. Congress intended by the statute involved to level out the ups and downs of **individual business enterprises, not combinations thereof** owned by different taxpayers.

Since this case was argued there has been called to our attention a case of the United States Court of Appeals for the Ninth Circuit, **E. & J. Gallo Winery, a Corp., Petitioner, v. Commissioner of Internal Revenue**, No. 14,180, decided November 9, 1955. That case involved a statutory merger of two corporations under the laws of California. The facts disclosed in the opinion do not indicate whether or not there was involved a continuing enterprise, that is, "continuity of business." The court therein distinguished the case before it from the **New Colonial Ice** case on the ground that in the **Gallo** case there was a true statutory merger and in the **New Colonial Ice** case "there was noth-

ing resembling a merger." Relying strongly on the **Stanton** case, the court said, page 8:

> "We hold and **Stanton** held, that the surviving corporation is the 'taxpayer,' who may use the unused excess profits tax credit of the former corporation."

Apparently the **Gallo** and **Stanton** cases stand on the same footing. Nevertheless, insofar as it can be said that they are parallel with the instant case, we must conclude that they are not persuasive.

Appellant also cites in support of its contention **Helvering, Commissioner of Internal Revenue, v. Metropolitan Edison Co.**, 1939, 306 U. S. 522. In that case the court stated at page 523:

> "These cases present the question whether, under the Revenue Acts of 1926 and 1928, a Pennsylvania corporation may deduct unamortized bond discount and expense in connection with redemption of the bonds of a subsidiary, all of whose assets it had previously acquired pursuant to local law."

That case holds that where a transferee corporation becomes liable for the debts of the transferor because of a merger, it may deduct losses or expenses arising out of the assumed debts, such as unamortized discount on bonds issued by the transferor. That is not the situation confronting the court in this case. The appellant here is not attempting to deduct a post-merger expense or loss of its own arising out of the assumption of the debts of the merged corporations, but to carry over and deduct pre-merger operating losses of three of the merged corporations. Furthermore, in the **Metropolitan Edison** case, the Supreme Court stated at page 529:

> "It is important to note, however, that amongst the liabilities assumed were bonds on which the parent company was already liable as guarantor."

We do not consider **Metropolitan Edison** as authority for appellant's contention.

It is significant, in drawing fact distinctions between the case at bar and those relied on by the appellant, that the merged corporations in the present instance were not all of the same state. Of the three corporations which sustained losses which the appellant is attempting to take as net operating loss carry-overs, two of such corporations were from the State of Illinois and one from the State of Missouri. We find it particularly difficult to say that two legal entities brought into existence by the laws of the State of Illinois are now identical with and have become a creature brought into existence by the laws of Missouri.

In **Newmarket Mfg. Co. v. United States** (D. C. Mass., 1955), 130 F. Supp. 706, the court had before it a situation almost on all fours with that confronting this court. There a Massachusetts corporation had caused the organization of a Delaware corporation. Subsequently the Massachusetts corporation was merged into and consolidated with the Delaware corporation. The consolidated corporation became liable for all the obligations of the Massachusetts corporation. It had the same business as the Massachusetts corporation, the same officers, the same stockholders and the same outstanding stock certificates. After the merger, the Massachusetts corporation ceased to exist as a separate corporation. The question there was whether, under §122 of the Revenue Code of 1939, as amended, 26 U. S. C. A., §122, "* * * a net operating loss incurred by the consolidated corporation in its fiscal year December 1, 1951, to November 30, 1952 (that is, after the merger) may be carried back to be deducted from the income tax liability attributable to the separate operations of the Massachusetts corporation for the period * * *" before the merger.

In a well-reasoned opinion, the court therein stated, at page 707:

"Where identity between the merging corporations and the consolidated corporation is recognized by local law, then, so the argument runs, the federal tax law accepts the identity. Indeed, it is said, such identity has been recognized in connection with carry-back provisions, **Moldit, Inc., v. Jarecki**, D. C. N. D. Ill., Aug. 13, 1953 (P. H. par. 72, 681), as well as in connection with unused excess profits credits. **Stanton Brewery, Inc., v. Commissioner**, 2 Cir., 176 F. 2d 573.

"There are two fundamental vices in this argument. First is the erroneous assumption that the federal tax law determines the identity of the taxpayer under federal law by reference to state rules of law or private agreements governing mergers. However, the question whether the same taxpayer is involved in two different accounting periods under federal law is to be decided exclusively by federal tax law. Second is the fallacious proposition that the Delaware corporation is the same person as the Massachusetts corporation merely having, as plaintiff's brief contends, another domicil and another name. However, even if the situation at bar involved two corporations chartered by the same state it would not be true that the identity of one corporation survives when merged with another."

The court held:

"* * * that under §122 of the Internal Revenue Code of 1939 a consolidated corporation cannot carry back its losses in one year to reduce the tax liability incurred in an earlier year due to operations of one of its constituent corporations."

When Congress passed the statute here involved it was concerned with eliminating inequality, taxwise, between a business with alternating profit and loss as compared with

a business with stable profits. It allowed the lean years of a business with alternating profit and loss to be set-off against the good years so as to strike an equitable tax liability as compared to a business having steady profits. We find nothing to suggest that Congress intended that a number of individual enterprises could pool their economic ups and downs and thus level off their tax burden between them. Congress was concerned with the economic fortunes of individual taxpayers, not combinations thereof.

Affirmed.

A true copy.

Attest:

Clerk, U. S. Court of Appeals, Eighth Circuit.

2. Text of Statutes Involved:

Section 23 (s), Internal Revenue Code of 1939:

"Deductions from gross income. In computing net income there shall be allowed as deductions: * * *

(s) Net operating loss deduction. For any taxable year beginning after December 31, 1939, the net operating loss deduction computed under section 122" (26 U. S. C., Sec. 23 (s).

Section 122(b) (2) (C), Internal Revenue Code of 1939, as amended by Revenue Act of 1951, 65 Stat. 452, effective for taxable years beginning after December 31, 1948:

"Net operating loss deduction.

* * * * * * * *

(b) Amount of carry-back and carry-over.

* * * * * * * *

(2) Net operating loss carry-over.

* * * * * * * *

(C) Loss for taxable year beginning after December 31, 1947, and before January 1, 1950. If for any tax-

able year beginning after December 31, 1947, and before January 1, 1950, the taxpayer has a net operating loss, such net operating loss shall be a net operating loss carry-over for each of the three succeeding taxable years, except that the carry-over in the case of each such succeeding taxable year (other than the first succeeding taxable year) shall be the excess, if any, of the amount of such net operating loss over the sum of the net income for each of the intervening years computed—

(i) with the exceptions, additions, and limitations provided in subsection (d) (1), (2), (4), and (6), and

(ii) by determining the net operating loss deduction for each intervening taxable year without regard to such net operating loss or to the net operating loss for any succeeding taxable year and without regard to any reduction specified in subsection (c).

"For the purpose of the preceding sentence, the net operating loss for any taxable year beginning after December 31, 1947, and before January 1, 1950, shall be reduced by the sum of the net income for each of the two preceding taxable years computed—

(iii) with the exceptions, additions and limitations provided in subsection (d) (1), (2), (4), and (6), and

(iv) by determining the net operating loss deduction without regard to such net operating loss or to the net operating loss for the succeeding taxable year, and without regard to any reduction specified in subsection (c)" (26 U. S. C., Sec. 122 [b] [2] [C] [1952]).